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LIFTING THE IRON CURTAIN OF AUTOMOBILE INSURANCE REGULATION

I. INTRODUCTION

Until March 1, 1999, male next-door neighbors with clean driving records will pay the same automobile insurance premium in South Carolina even though one man is fifty-five years old and the other is twenty-five, assuming they drive similar cars an equal distance to work.¹ Additionally, a twenty-one-year-old male who owns a car could lower his insurance rates by marrying his girlfriend.² While this may appear odd, it is a reflection of South Carolina's highly regulated insurance system. However, the current law also has many important consumer protections.³ For example, an insurance company may not charge higher liability rates to an innocent driver involved in an accident if the other driver is convicted of a traffic violation.⁴

The South Carolina General Assembly adopted the state's current automobile insurance system in 1974.⁵ In 1997 the General Assembly enacted a major revision of the system.⁶ The new law will transform South Carolina's highly regulated automobile insurance industry into a competitive system modeled after the law of Virginia.⁷ Most importantly, insurance companies will no longer be required to

1. All males over 25 that drive less than ten miles to work are in the same rating category. *See* 25A S.C. CODE ANN. REGS. 69-13.4, § II (1976) (repealed). Although this regulation has been repealed, the old classifications are still in use because the South Carolina Department of Insurance has declined to create new classifications. *See* South Carolina Dep't of Ins., Order No. 11-96 (Nov. 1, 1996) (noting that the Department of Insurance "has not revised the uniform classification plan" and directing "insurers to continue to use the classification plan"). The Department has not issued new classifications because new legislation has given that ability to the private sector. *See* Act of July 2, 1997, No. 154, 1997 S.C. Acts 931.

2. *See* 25A S.C. CODE ANN. REGS. 69-13.4, § II (1976) (repealed 1996). An unmarried twenty-one-year-old male who owns his own car would have a premium relativity factor of 2.4. *Id.* §§ II, IV. If married, the same male would have a relativity factor of 1.6. *Id.*

3. *See, e.g.,* S.C. CODE ANN. § 38-77-110 (Law. Co-op. Supp. 1997) (repealed effective Mar. 1, 1999) (requiring insurance companies to write policies for all customers that apply).

4. *See* 25A S.C. CODE ANN. REGS. 69-13.1 § III.A.4. (Supp. 1997) (effective until Mar. 1, 1999).

5. *See* Act of July 9, 1974, No. 1177, 1974 S.C. Acts 2718 (creating the mandatory writing requirement and the Reinsurance Facility).

6. *See* Act of July 2, 1997, No. 154, 1997 S.C. Acts 931.

7. VA. CODE ANN. § 38.2 (Michie 1994). North Carolina, Kentucky, and Florida were also considered as models. *See* Jim Parker, *Virginia is for Drivers*, THE POST AND COURIER (Charleston, S.C.), Sept. 7, 1997, at 16A.

write insurance for drivers they do not want.⁸ Insurance companies will also be able to raise and lower their rates up to seven percent without seeking prior approval from the Department of Insurance.⁹ These changes are designed to increase the number of insurance companies providing insurance in the state.¹⁰ The General Assembly has chosen increased competition, instead of regulation, to keep insurance prices in check.¹¹

Understanding an automobile insurance policy is no small feat. An automotive policy in South Carolina must include liability coverage and uninsured motorist coverage.¹² Liability coverage protects a driver from bodily injury and property damage caused by his own negligence.¹³ An uninsured motorist provision provides coverage for a driver involved in a collision with a motorist that has no insurance or with an unidentified motorist, such as a hit-and-run driver.¹⁴

This Note focuses principally on automobile liability insurance, one component of an automobile insurance policy. Part II identifies alternate insurance mechanisms that can be used to provide automobile liability coverage and briefly discusses the history and future of automobile insurance in South Carolina. Part III narrates the mechanics of the new law, including the uninsured motorist option, the end of mandatory writing, and the new flexibility insurance companies have to set rates. Part IV deals with the mechanics of the new residual market mechanisms. Part V examines the changes in the residual market mechanism and the effect on rates and compares the mechanism with those of other states. Part VI addresses several minor changes in automobile insurance law included in the recent legislation, such as the increase in property damage coverage and the requirement that drivers carry proof of insurance.

II. AUTOMOBILE LIABILITY INSURANCE SYSTEMS

A. *How Drivers Obtain Liability Coverage*

Insurance companies evaluate prospective insureds in three principal ways:

8. Act of July 2, 1997, No. 154, 1997 S.C. Acts 931, 959-60 (effective Mar. 1, 1999) (repealing S.C. CODE ANN. § 38-77-110 (Law. Co-op. Supp. 1997)).

9. *Id.* at 951-53 (repealing S.C. CODE ANN. § 38-73-910(B) (Law. Co-op. Supp. 1997) (effective Mar. 1, 1999)).

10. See Jim Davenport, *Safe Drivers Might Lose Under Plan*, THE STATE (Columbia, S.C.), June 15, 1997, at A1.

11. See Jim Davenport, *S.C. Automobile Insurance Reform is Complex Issue*, THE STATE (Columbia, S.C.), Mar. 24, 1997, at Moneywise 3.

12. See S.C. CODE ANN. § 38-77-30(1) (Law. Co-op. Supp. 1997) (requiring liability and uninsured coverage in policy); *Garris v. Cincinnati Ins. Co.*, 280 S.C. 149, 154, 311 S.E.2d 723, 726 (1984).

13. See S.C. CODE ANN. § 56-9-20(5) (Law. Co-op. Supp. 1997) (defining "Motor vehicle liability policy").

14. See S.C. CODE ANN. § 38-77-30(14) (Law. Co-op. Supp. 1997) (effective Mar. 1, 1999).

underwriting, coverage, and rating.¹⁵ Underwriting requires an initial decision of whether to insure a particular type of driver.¹⁶ Coverage dictates the amount of insurance the company is willing to sell to a driver.¹⁷ Rating determines how much the company will charge for providing coverage to a particular risk group.¹⁸ Decisions in all three areas are based on how likely a carrier thinks a driver is to suffer a loss.¹⁹ Insurance companies use personal data to predict future losses and to aid in screening out drivers that are likely to be unprofitable.²⁰

All fifty states have financial responsibility laws pertaining to driving.²¹ These laws have not always required that car owners obtain insurance.²² The earliest financial responsibility laws required drivers to obtain insurance after they had an accident and were unable to pay a judgement entered against them.²³ These laws proved ineffective because the initial victim often went uncompensated.²⁴ Currently, South Carolina requires a driver to have automobile insurance to register a vehicle.²⁵ Such compulsory insurance laws are designed to ensure that accident victims are able to recover their losses.²⁶

Drivers that are able to find insurance companies willing to insure them are insured in the voluntary market.²⁷ An unsafe driver, however, may not be able to find an insurance company in the voluntary market. To aid these drivers in complying with financial responsibility laws, states have created residual market mechanisms.²⁸ Essentially, these state-sponsored insurance companies provide coverage for drivers that private insurance companies are unwilling to insure.²⁹ Residual market mechanisms generally fall into one of three varieties: assigned risk plans, joint underwriting associations, and reinsurance facilities.³⁰ However, residual market mechanisms can differ greatly within the same category from one state to another.³¹

15. See Jill Gaulding, Note, *Race, Sex, and Genetic Discrimination in Insurance: What's Fair?*, 80 CORNELL L. REV. 1646, 1651 (1995).

16. *Id.*

17. *Id.*

18. *Id.* at 1652.

19. *Id.*

20. See *id.* at 1652.

21. See BURNET R. MAYBANK, III ET AL., THE LAW OF AUTOMOBILE INSURANCE IN SOUTH CAROLINA II-1 (3d. ed. 1996).

22. See *id.* at II-1.

23. *Id.*

24. *Id.*

25. See S.C. CODE ANN. § 56-10-220 (Law. Co-op. Supp. 1997).

26. See MAYBANK ET AL., *supra* note 21, at II-4.

27. Suzanne Yelen, Note, *Withdrawal Restrictions in the Automobile Insurance Market*, 102 YALE L.J. 1431, 1433 (1993).

28. See JUDITH K. MINTEL, INSURANCE RATE LITIGATION 231-32 (1983).

29. See SOUTH CAROLINA LEGISLATIVE AUDIT COUNCIL, AUTOMOBILE INSURANCE IN SOUTH CAROLINA 1 (1997).

30. *Id.* at 1-2.

31. *Id.* at 1.

Assigned risk plans are by far the most common residual market mechanism.³² Assigned risk plans assign drivers unable to find insurance coverage in the voluntary market to an insurance carrier.³³ The plan administrator randomly assigns these risks among all insurance companies operating in a state based upon each company's market share.³⁴ Insurance companies are required to write policies for every client assigned, and they must individualize all losses or profits derived from assigned clients.³⁵ Individualized profits and losses distinguish assigned risk plans from the other types of residual market mechanisms, which share profits or losses among all insurance companies.³⁶

Joint underwriting associations, or JUAs, also allow insurance companies to refuse clients.³⁷ Drivers that are unable to purchase insurance in the voluntary market are placed in the state's JUA.³⁸ The JUA then writes a policy through a servicing carrier, an insurance company that handles the claims and billing for a fee.³⁹ The JUA spreads the losses or profits from its policies among all the insurance companies in the state.⁴⁰

Reinsurance facilities require all insurance companies to write policies for every driver that applies for coverage.⁴¹ Insurance companies are then given the option of ceding policies they believe to be unprofitable to the reinsurance facility, "which is a joint risk pool of all insurance companies."⁴² Individual insurance companies do not sustain losses from drivers they turn over to the facility.⁴³ Losses from ceded policies are assumed by the facility and recovered through either assessments or taxes.⁴⁴

B. A Brief Overview of the History and Future of South Carolina's Insurance System

South Carolina had an assigned risk plan from 1947 to 1974.⁴⁵ Since 1974 South Carolina has operated the South Carolina Reinsurance Facility.⁴⁶ The South Carolina Reinsurance Facility rates traditionally have not covered expenses.⁴⁷

32. *Id.* at 2.

33. *See id.*

34. *See* MINTEL, *supra* note 28, at 232.

35. *See* SOUTH CAROLINA LEGISLATIVE AUDIT COUNCIL, *supra* note 29, at 2.

36. *Id.*

37. *See* MAYBANK ET AL., *supra* note 21, at I-31.

38. SOUTH CAROLINA LEGISLATIVE AUDIT COUNCIL, *supra* note 29, at 2.

39. *Id.*

40. *Id.*

41. *Id.* at 1.

42. *Id.*

43. *See id.* at 1-2.

44. SOUTH CAROLINA LEGISLATIVE AUDIT COUNCIL, *supra* note 29, at 1-2.

45. *Id.* at 3.

46. *See* MAYBANK ET AL., *supra* note 21, at I-33.

47. *See* SOUTH CAROLINA LEGISLATIVE AUDIT COUNCIL, *supra* note 29, at 4.

Losses sustained between 1974 and 1987 were absorbed by insurance companies and passed on to consumers in the form of higher rates.⁴⁸ In 1987 the General Assembly authorized the creation of a recoupment fee to be paid by all drivers in the state to reimburse the facility for its losses.⁴⁹ The General Assembly prospectively eliminated the Reinsurance Facility in 1997.⁵⁰ From March 1, 1999, to February 28, 2003, drivers unable to find voluntary insurance will be placed in a joint underwriting association.⁵¹ This JUA will be replaced by an assigned risk plan on March 1, 2003.⁵²

III. THE DETAILS OF THE NEW LAW

The new insurance law adopted by the General Assembly will change the way insurance is bought, sold, and regulated in South Carolina. The new legislation will also give drivers the opportunity to forgo insurance completely and operate legally as uninsured motorists.

A. *The Uninsured Motorist Option*

The uninsured motorist option mirrors a Virginia law.⁵³ Currently, South Carolina requires all vehicles to be covered by liability insurance.⁵⁴ Beginning February 1, 1999, South Carolina residents that qualify and pay a fee will be exempted from this requirement.⁵⁵ Drivers that carry liability insurance will continue to be protected from uninsured drivers by their uninsured motorist coverage included in their liability policies.⁵⁶ However, the law allows insurance companies to recover any losses they suffer from uninsured motorist coverage by suing the uninsured motorist personally.⁵⁷ Therefore, drivers opting to be uninsured will still be liable for damages even if the injured driver's insurance company

48. *Id.*

49. *Id.*

50. Act of July 2, 1997, No. 154, 1997 S.C. Acts 931.

51. See S.C. CODE ANN. §§ 38-91-10 to -420 (Law. Co-op. Supp. 1997) (effective from Mar. 1, 1999, until Feb. 28, 2003).

52. See S.C. CODE ANN. §§ 38-77-810 to -880 (Law. Co-op. Supp. 1997) (effective Mar. 1, 2003).

53. See VA. CODE ANN. § 46.2-706 (Michie 1996).

54. See S.C. CODE ANN. § 56-10-220 (Law. Co-op. Supp. 1997).

55. See S.C. CODE ANN. § 56-10-510 (Law. Co-op. Supp. 1997) (effective Feb. 1, 1999) (allowing uninsured motorists).

56. All liability policies in South Carolina will still be required to provide uninsured motorist coverage. See S.C. CODE ANN. § 38-77-140 (Law. Co-op. 1989 & Supp. 1997). Beginning March 1, 1999, all automobile policies providing coverage beyond the state law minimum will automatically include uninsured motorist coverage of the same amount unless the consumer elects otherwise. S.C. CODE ANN. § 38-77-141 (Law. Co-op. Supp. 1997) (effective Mar. 1, 1999). However, an insurer can charge a higher premium for the additional coverage. *Id.*

57. S.C. CODE ANN. § 38-77-150(C) (Law. Co-op. Supp. 1997) (effective Mar. 1, 1999).

covers the loss.

1. *Who Qualifies?*

To protect the public from high-risk drivers, the General Assembly has disqualified many classes of drivers from electing to be uninsured motorists.⁵⁸ For example, drivers that have been convicted of driving under the influence of alcohol or drugs, reckless driving that causes damage or injury, or three or more moving traffic violations are not allowed to exercise the option.⁵⁹ Additionally, drivers that have caused two or more accidents will be ineligible.⁶⁰ Finally, the General Assembly has precluded drivers that have been licensed for less than three years, and all members of their households, from electing to be uninsured.⁶¹ These limitations are designed to permit only "good" drivers to be uninsured motorists.

2. *The Fee and Its Distribution*

The uninsured motorist election will require an annual fee of \$550.⁶² The fee is not insurance,⁶³ instead, the fee only gives the individual the privilege to drive on South Carolina roads.⁶⁴ The first \$50 of the fee will go to the Reinsurance Facility as long as it continues to exist.⁶⁵ The remaining \$500 will go to the Uninsured Motorists Fund.⁶⁶ Ten percent of the money provided to the Uninsured Motorists Fund will be retained by the Department of Insurance to implement several new programs created by the legislation.⁶⁷ These programs include the preparation of "an automobile insurance buyer's guide, a brochure comparing automobile insurance premiums, and . . . a public awareness campaign."⁶⁸ The \$500 fee will also pay for enforcement of the legislation's antidiscrimination provisions.⁶⁹ The Department will distribute the remaining funds to insurance companies to reimburse losses sustained on uninsured motorist policies.⁷⁰

58. Specifically, the new law requires drivers that have been convicted of certain offenses or have been in certain accidents to prove financial responsibility to pay for future accidents. *See* S.C. CODE ANN. § 56-10-535 (Law. Co-op. Supp. 1997) (effective Feb. 1, 1999).

59. *Id.*

60. *Id.*

61. *Id.*

62. S.C. CODE ANN. § 56-10-510 (Law. Co-op. Supp. 1997) (effective Feb. 1, 1999).

63. *Id.*

64. *Id.*

65. S.C. CODE ANN. § 56-10-554 (Law. Co-op. Supp. 1997) (effective Feb. 1, 1999).

66. S.C. CODE ANN. § 38-77-151 (Law. Co-op. Supp. 1997) (effective Mar. 1, 1999).

67. *See id.*

68. *Id.*

69. *See id.* (providing money to enforce S.C. CODE ANN. §§ 38-77-112, -122, -123 (Law. Co-op. Supp. 1997) (effective Mar. 1, 1999)).

70. S.C. CODE ANN. § 38-77-155 (Law. Co-op. Supp. 1997) (effective Mar. 1, 1999).

3. *The Effect on Motorists*

The effects of this new law should not be substantial. The General Assembly has limited the election to drivers with relatively good driving records.⁷¹ According to statistics from the National Association of Insurance Commissioners, the average liability premium in South Carolina in 1996 was \$396.⁷² Adding the \$50 recoupment fee paid by drivers without insurance points,⁷³ the average cost of driving insured was \$446. For many South Carolinians, driving uninsured would cost more than purchasing insurance.⁷⁴ However, few drivers will likely assume the great risk of driving uninsured given the relatively high fee, its unavailability to motorists with bad driving records, and potential exposure to personal liability in the event of an accident.

B. Elimination of the Requirement to Write Insurance

Under current law, insurance companies are required to write automobile policies for all applicants that have a valid driver's license.⁷⁵ After February 28, 1999, insurance companies will no longer be required to write policies for all customers that walk in their doors.⁷⁶ As a result, insurance companies may choose their insureds. However, the choice is not unfettered. Antidiscrimination laws prevent insurance companies from using race, sex, and other similar characteristics as factors in underwriting.⁷⁷ The automobile insurance consumers will suffer a major loss because they can no longer demand insurance from the lowest cost provider.⁷⁸ However, the change in South Carolina's residual market mechanism protects drivers that cannot find voluntary insurance without requiring every insurance company to write policies for all drivers.⁷⁹

71. See *supra* text accompanying notes 58-61.

72. Jim Davenport, *Automobile Insurance Rate Survey Shows Little Increase in S.C.*, THE STATE (Columbia, S.C.), Feb. 13, 1998, at B7.

73. SOUTH CAROLINA LEGISLATIVE AUDIT COUNCIL, *supra* note 29, at 5.

74. However, "bad" drivers might be willing to pay the uninsured motorist fee because their rates are higher than average. Many of these drivers, however, will not be eligible. See *supra* text accompanying notes 59-61.

75. See S.C. CODE ANN. § 38-77-110 (Law. Co-op. Supp. 1997) (effective until Mar. 1, 1999); Bell v. Allstate Ins. Co., 822 F. Supp. 1222, 1223 n.1 (D.S.C. 1992).

76. Act of July 2, 1997, No. 154, 1997 S.C. Acts 931, 959-60.

77. See S.C. CODE ANN. § 38-77-122(a) (Law. Co-op. Supp. 1997) (effective Mar. 1, 1999) (listing criteria insurance companies are not to consider when making underwriting decisions).

78. See Davenport, *supra* note 11 (describing the author's personal benefit from the ability to demand insurance from the lowest cost provider).

79. A mandate to write would be logically inconsistent with a JUA or an assigned risk plan. The hallmark of both is the ability of the insurance company to refuse to issue policies. See *supra* notes 33-40 and accompanying text.

C. *Elimination of Controlled Rate Increases*

States control insurance rates in many ways, varying from systems that allow the companies freedom to set rates to systems that actually set rates.⁸⁰ The tension between the two extremes is in the market's ability to keep insurance rates reasonable. The market approach relies on the assumption that a properly functioning market will not allow some companies to charge higher rates;⁸¹ companies that do will lose their market share.⁸² The market should also prevent insurance companies from charging rates so low that they jeopardize the ability to pay claims.⁸³ Under the competitive model, insurance companies can react quickly to market forces and are free from political pressures that can affect regulatory models.⁸⁴ However, the model requires a properly functioning market and consumers that can make informed, rational decisions.⁸⁵ In contrast, the regulatory approach assumes that state control is a better method for setting rates.⁸⁶

Until March 1, 1999, South Carolina will continue to require insurance companies to get prior approval for rate increases.⁸⁷ Prior approval allows the Department of Insurance to control rates by refusing requests for higher rates.⁸⁸ The new law, effective March 1, 1999, will allow insurance companies to raise and lower rates up to seven percent each year from the previous year.⁸⁹ However, individuals could see their rates increase by more than seven percent because the new law only limits increases of rating classifications and does not apply to individuals.⁹⁰ Nevertheless, the new law is a significant step toward allowing market forces to control the insurance industry.

D. *Relative Freedom in Rating*

Rating classifications or tiers allow insurance companies to allocate risk among

80. See MINTEL, *supra* note 28, at 4.

81. INSURANCE INFORMATION INSTITUTE, *Rate Regulation*, in INS. ISSUES UPDATE, Dec. 1997, at 44, available in LEXIS, Insure Library, IIRPTS File [hereinafter *Rate Regulation*].

82. See *id.*

83. See *id.*

84. See *id.*

85. *Cf. id.* (market control assumes properly functioning market). State insurance departments can play an important role in ensuring that consumers have the information to choose between insurance companies. See S.C. CODE ANN. § 38-73-1085 (Law. Co-op. Supp. 1997) (requiring S.C. Department of Insurance to post rates of 20 largest insurance companies in the state).

86. *Id.*

87. See S.C. CODE ANN. § 38-73-910 (Law. Co-op. Supp. 1997).

88. See S.C. CODE ANN. §§ 38-73-990, 1020 (Law. Co-op. Supp. 1997) (allowing director or his designee to disapprove filings).

89. See S.C. CODE ANN. § 38-73-910(B) (Law. Co-op. Supp. 1997) (as amended effective Mar. 1, 1999).

90. See *id.*

different customers based on actuarial factors.⁹¹ Allowing insurance companies to set their own tiers enables each company to charge premiums based on what it considers to be “risky characteristics,” such as age or lack of driving experience.⁹² Rating classification entails many competing and sometimes contradicting goals.⁹³ For an insurance company to use a particular factor in rating, the administrative cost in verifying that factor must be weighed against the benefit of using it.⁹⁴ If an insurance company chooses not to verify a risk classification, the benefit from separating drivers based on that classification can be lost.⁹⁵ An example may be illustrative. Age, sex, location of residence, and driving record can all be easily obtained and verified. These characteristics would be ideal candidates for a rating system. Miles driven annually is also a statistically sound predictor of risk.⁹⁶ However, verifying miles driven annually would be an enormous problem for an insurance company. Therefore, the category is only marginally useful in rating.⁹⁷

In addition to market forces, insurance rating is also limited by antidiscrimination laws that prevent unfair classifications.⁹⁸ However, fairness depends on one’s perspective. The antidiscrimination perspective focuses on preventing insurance companies from using immutable factors such as race or sex.⁹⁹ Ratings and classifications based on these types of qualities ignore driving ability and history, which are key components of automobile insurance risk.¹⁰⁰ The “efficient discrimination” perspective focuses on factors closely associated with actual risk including race, sex, and other politically volatile characteristics.¹⁰¹ Efficient discrimination allows insurance companies to use these immutable characteristics to charge higher premiums when these characteristics “are statistically correlated to higher risks of loss.”¹⁰²

The tension between the two perspectives is best viewed by analyzing gender classifications. Sex “correlates with many risk factors, including . . . number of automobile accidents.”¹⁰³ Female drivers cause fewer automobile losses and are charged lower rates than men.¹⁰⁴ Supporters of the antidiscrimination view would argue that it is unfair to charge men more than women simply because of their sex. Most state legislatures have rejected this view, but it has been accepted in Hawaii,

91. See Gaulding, *supra* note 15, at 1652.

92. See Kenneth S. Abraham, *Efficiency and Fairness in Insurance Risk Classification*, 71 VA. L. REV. 403, 408 (1985).

93. See *id.* at 408-20.

94. See *id.* at 407-08.

95. See *id.* at 412-13.

96. *Id.* at 412.

97. See *id.*

98. See Gaulding, *supra* note 15, at 1647.

99. *Id.*

100. See *Rate Regulation*, *supra* note 81.

101. Gaulding, *supra* note 15, at 1647.

102. *Id.*

103. *Id.* at 1661.

104. *Id.* at 1663.

Massachusetts, Michigan, and North Carolina.¹⁰⁵ Proponents of the efficient discrimination view would argue that sex classifications are good predictors of risk; thus, women should not have to subsidize men's higher accident rate.¹⁰⁶ Although the use of immutable characteristics in setting rates is controversial, an insured's driving record and loss history are more important factors in determining premiums.¹⁰⁷

1. *The Current Law*

The current law, effective until March 1, 1999, requires all insurance companies to use the South Carolina Merit Rating Plan.¹⁰⁸ The Merit Rating Plan uses the Uniform Classification Plan¹⁰⁹ to divide drivers into twenty-two classes based on such factors as age, sex, marital status, and distance driven each day.¹¹⁰ This plan also divides South Carolina into territories consisting of individual counties and groups of smaller counties.¹¹¹ Each insurance company must set a base rate for each classification and territory.¹¹² Drivers with "bad" driving records are charged a higher rate, called the objective standard rate, which is twenty-five percent higher than the base rate.¹¹³ Additionally, each insurance company is required to have a safe driver discount, which is twenty percent below the base rate for each classification and territory.¹¹⁴ All insurance companies are then required to allocate risk, or penalize drivers for bad conduct, in the same manner.¹¹⁵

The Merit Rating Plan penalizes a driver with points accumulated from traffic offenses or accidents. The penalty is calculated by multiplying the total points,

105. See *id.* at 1663 n.106 (citing HAW. REV. STAT. § 294-33 (1976) (now found at HAW. REV. STAT. ANN. § 431:10C-207 (Michie 1994)), MASS. GEN. LAWS ANN. ch. 175, §§ 22E, 24A (West 1987 & Supp. 1997), MICH. COMP. LAWS ANN. § 500.2027 (West 1993), and N.C. GEN. STAT. § 58-3-25 (1994)).

106. Gauling, *supra* note 15, at 1647.

107. See *Rate Regulation*, *supra* note 81, at 47.

108. See S.C. CODE ANN. § 38-73-760(a) (Law. Co-op. Supp. 1997) (requiring the use of the Merit Rating Plan); 25A S.C. CODE ANN. REGS. 69-13.1 (Supp. 1997).

109. See 25A S.C. CODE ANN. REGS. 69-13.4 (1976) (repealed 1996). For an explanation of why this repealed regulation is still in use, see South Carolina Dep't of Ins., Order No. 11-96 (Nov. 1, 1996).

110. See South Carolina Dep't of Ins., Order No. 11-96 (Nov. 1, 1996).

111. 25A S.C. CODE ANN. REGS. 69-13.4 (1976) (repealed 1996).

112. S.C. CODE ANN. § 38-73-455 (Law. Co-op. Supp. 1997) (effective until Mar. 1, 1999). To calculate the base rate, see S.C. CODE ANN. § 38-73-457 (Law. Co-op. Supp. 1997) (effective until Mar. 1, 1999).

113. S.C. CODE ANN. § 38-73-455 (Law. Co-op. Supp. 1997) (effective until Mar. 1, 1999).

114. S.C. CODE ANN. § 38-73-760(e) (Law. Co-op. Supp. 1997) (effective until Mar. 1, 1999). The new law creates a safe driver discount for drivers over 55 years old that take a driver training course. However, the discount rate is left to the individual insurance companies. S.C. CODE ANN. § 38-73-736 (Law. Co-op. Supp. 1997).

115. See 25A S.C. CODE ANN. REGS. 69-13.1 II(E)(3) (Supp. 1997) (effective until Mar. 1, 1999).

minus one free point, by twenty dollars.¹¹⁶ This sum is then added to the driver's base rate, or the objective standard rate, to create the liability premium.¹¹⁷ Under the plan, a traffic violation carries the same premium increase for all insurance companies.¹¹⁸ For example, a DUI with property damage or injury is a penalty of twenty points.¹¹⁹ Assessed at twenty dollars per point, except for the first free point, the premium increase would be \$380,¹²⁰ assuming the driver was already being charged the objective standard rate. Any difference in the amount of a driver's premium from one insurance company to the next would be due to a different base rate.¹²¹ Therefore, an informed consumer can easily shop around by comparing base rates.

2. *The New Law*

The new law abolishes the Merit Rating Plan and allows individual insurance companies to set their own rating tiers.¹²² Additionally, the repeal of the Uniform Classification Plan will allow insurance companies to classify drivers as they see fit.¹²³ While not providing any strict guidelines, the General Assembly has forbidden rating based upon consideration of "race, color, creed, religion, national origin, ancestry, location of residence in this State, economic status, or income level."¹²⁴ Conspicuously absent from this list are age, sex, occupation, and family status.¹²⁵

The new law eliminates the three-year forgiveness rule, which removes violations older than three years from consideration in setting rates.¹²⁶ Under the new law, insurance companies can look back as far as they desire to allocate extra

116. *Id.*

117. *Id.*

118. *See id.*

119. *Id.* at III(B)(1).

120. The increase in the liability premium is minimal compared to the increase in the recoupment fee. Drivers with ten or more insurance points pay over \$2,200 more annually in recoupment fees than drivers with no points. *See* SOUTH CAROLINA LEGISLATIVE AUDIT COUNCIL, *supra* note 29, at 5.

121. *See* 25A S.C. CODE ANN. REGS. 69-13.1 II(E)(3) (Supp. 1997) (effective until Mar. 1, 1999) (the Uniform Merit Plan penalizes drivers for their driving records equally).

122. Act of July 2, 1997, No. 154, 1997 S.C. Acts 931. The 1997 Act repealed many of South Carolina's rate regulating statutes. *See, e.g.,* S.C. CODE ANN. § 38-73-455 (Law. Co-op. Supp. 1997) (repealed effective Mar. 1, 1999) (requiring base rate and objective standard rate); S.C. CODE ANN. § 38-73-760 (Law. Co-op. Supp. 1997) (repealed effective Mar. 1, 1999) (requiring Department of Insurance to create uniform classifications).

123. *See supra* note 1 (explaining that classification plan is still being used even though it has been repealed).

124. S.C. CODE ANN. § 38-77-122(B) (Law. Co-op. Supp. 1997) (effective Mar. 1, 1999).

125. The omission of these characteristics was intentional. In the very next sentence of section 38-77-122(B), the General Assembly includes age and sex as protected categories in terms of renewing a policy. *Id.* Additionally, occupation and family status are included earlier in the section as protected in underwriting decisions. *Id.* § 38-77-122(A).

126. The Merit Plan only looks at the past three years. *See* 25A S.C. CODE ANN. REGS. 69-13.1 II(B) (Supp. 1997), *repealed by* Act of July 2, 1997, No. 154, 1997 S.C. Acts 931.

premiums.¹²⁷ The insurance industry had complained about the three-year rule because it still considered as risky those drivers that had accidents more than three years before.¹²⁸

Under the new law, insurance companies can also raise rates for drivers arrested but not convicted of crimes like driving under the influence.¹²⁹ Additionally, insurers may raise rates for certain first offenses such as driving with a defective tail light, driving too fast for conditions, or violating county or municipal safety ordinances.¹³⁰

E. Elimination of the Recoupment Fee

Of all the changes enacted by the new legislation, none was more politically charged than the elimination of the recoupment fee.¹³¹ The recoupment fee was created by the General Assembly in 1987 to compensate insurance companies for losses they were required to pay to the Reinsurance Facility.¹³² The recoupment fee is paid by all drivers whether or not their policies are backed by the Reinsurance Facility.¹³³ Therefore, drivers with policies not covered by the Facility annually subsidize the rates of the Facility's drivers.¹³⁴

The new law will gradually eliminate the recoupment fee. Beginning March 1, 1999, all new policies will have a maximum recoupment fee equal to ten percent of the liability premium.¹³⁵ The statutory change will replace the previous recoupment formula and will reduce the fees paid by some drivers.¹³⁶ Drivers with a high number of insurance points are likely to benefit most from this change.¹³⁷ For example, drivers with ten or more insurance points paid a recoupment fee of \$2,300 for liability coverage in 1996-1997.¹³⁸ With the ten percent cap, drivers will have to pay \$23,000 for liability policies for the Reinsurance Facility to continue its funding at the present level. No provision in the new law will make up for this

127. Act of July 2, 1997, No. 154, 1997 S.C. Acts 931.

128. See Davenport, *supra* note 10.

129. The Merit Rating Plan prohibits increases from arrests that did not result in convictions. 25A S.C. CODE ANN. REGS. 69-13.1 III(A)(10) (Supp. 1997), *repealed by* Act of July 2, 1997, No. 154, 1997 S.C. Acts 931.

130. S.C. CODE ANN. § 38-77-360 (Law. Co-op. Supp. 1997), *repealed by* Act of July 2, 1997, No. 154, 1997 S.C. Acts 931 (effective Mar. 1, 1999).

131. See MAYBANK ET AL., *supra* note 21, at XIV-29, 30; Davenport, *supra* note 10.

132. SOUTH CAROLINA LEGISLATIVE AUDIT COUNCIL, *supra* note 29, at 16.

133. S.C. CODE ANN. § 38-77-600 (Law. Co-op. Supp. 1997) (repealed effective Jan. 1, 2006)).

134. See SOUTH CAROLINA LEGISLATIVE AUDIT COUNCIL, *supra* note 29, at 16. In 1993 42% of private passenger policies were in the Facility. *Id.* at 7.

135. S.C. CODE ANN. § 38-77-530 (Law. Co-op. Supp. 1997) (effective Mar. 1, 1999).

136. See S.C. CODE ANN. § 38-77-600 (Law. Co-op. Supp. 1997) (repealed effective Jan. 1, 2006) (the recoupment formula); Davenport, *supra* note 10 (stating that the 10 percent cap will lower recoupment fees for safe and high risk drivers).

137. Davenport, *supra* note 10.

138. SOUTH CAROLINA LEGISLATIVE AUDIT COUNCIL, *supra* note 29, at 5.

shortfall in the recoupment fee. However, the financial burden will be partially absorbed by the creation of the new JUA so that fewer policies will be in the Facility.¹³⁹ The recoupment fee, however, pays losses from the previous year in succeeding years, so the 1998 losses will have to be covered by the Facility subject to the 1999 restrictions.¹⁴⁰ As a result, the Facility will likely experience a shortfall that will be rolled over into subsequent years.¹⁴¹ These roll-overs will become more significant after March 1, 2002, when drivers without insurance points will no longer be required to pay a recoupment fee.¹⁴² Drivers with insurance points will be left to recoup all the losses in the Facility.¹⁴³ For drivers with no points, this reprieve from the recoupment fee will be a mixed blessing. By 2002 the fee will likely be lower because of the ten percent cap and the creation of the JUA. However, for those drivers with insurance points, retiring the debt of the Reinsurance Facility will be an unwelcome assignment.

F. Protection from Discrimination

Prior to the mandatory writing requirement, discrimination in underwriting was a serious problem in South Carolina.¹⁴⁴ In response to this problem, the General Assembly adopted a mandatory writing provision in 1974.¹⁴⁵ The mandatory writing provision eliminated discretion in underwriting and would, in theory, eliminate discrimination in the insurance industry.¹⁴⁶

The new law will again allow insurance companies to choose among potential customers. To prevent unfair discrimination, the General Assembly has mandated that insurance companies not consider the following characteristics in their underwriting decisions: "age, sex, location of residence in this State, race, color, creed, national origin, ancestry, marital status, or income level."¹⁴⁷ Additionally, insurance companies may not refuse to cover a driver for any of the following reasons without additional cause: refusal of insurance by another carrier, prior affiliation with either of the residual market mechanisms, and occupation.¹⁴⁸

To enforce these provisions, insurance agents are required to keep records for

139. The JUA will begin accepting new policies and renewals, decreasing the number of policies in the Facility, on March 1, 1999. S.C. CODE ANN. § 38-91-10 (Law. Co-op. Supp. 1997) (effective Mar. 1, 1999, until Feb. 28, 2003).

140. See S.C. CODE ANN. § 38-77-600 (Law. Co-op. Supp. 1997) (repealed effective Jan. 1, 2006).

141. See SOUTH CAROLINA LEGISLATIVE AUDIT COUNCIL, *supra* note 29, at 17. Shortfalls are nothing new for the Facility. *Id.* From July 1988 to June 1996, the Facility had a deficit and roll over in seven of eight years. *Id.*

142. S.C. CODE ANN. § 38-77-530 (Law. Co-op. Supp. 1997) (effective Mar. 1, 1999).

143. See *id.*

144. Cf. SOUTH CAROLINA LEGISLATIVE AUDIT COUNCIL, *supra* note 29, at 3.

145. *Id.*

146. *Id.*

147. S.C. CODE ANN. § 38-77-122(A) (Law. Co-op. Supp. 1997) (effective Mar. 1, 1999).

148. *Id.*

three years of all persons to whom coverage is denied.¹⁴⁹ The Uninsured Motorists Fund will finance the prosecution of violators.¹⁵⁰ The Director of the Department of Insurance has the authority to fine an agent or insurance company up to \$200,000 for violating these rules.¹⁵¹ The rules are substantially the same as the current law prohibiting discrimination in comprehensive coverage.¹⁵²

G. Cancellation and Nonrenewal

Cancellation is the termination of a "policy prior to the end of the policy period."¹⁵³ Failure to renew is the more common occurrence of an insurance company deciding not to provide a new policy after an original policy expires.¹⁵⁴ Cancellation can occur if the insured's driving license is suspended or if the insured fails to pay the policy premium.¹⁵⁵ However, in the first ninety days of a new policy, an insurance company may cancel a policy without cause.¹⁵⁶ Such a rule provides insurance companies time to investigate a client's driving record and other information provided on the insurance application.

Similar to the limitations on denying issuance of policies, antidiscrimination provisions protect insureds from unfair termination or nonrenewal. An insurance company may not refuse to renew a policy based on consideration of age, sex, location in the state, race, national origin, marital status, or income level.¹⁵⁷ Nor may an insurance company deny a policy renewal application for any of the following reasons without additional cause: occupation, lack of driving experience, lack of supporting business, accidents or violations older than three years, claims made under uninsured motorist coverage, claims for medical coverage in an accident in which the driver was not at fault, and one or two accidents within a three year period, unless the driver was at least partially at fault.¹⁵⁸

After cancellation or nonrenewal, a driver has fifteen days to request review of

149. S.C. CODE ANN. § 38-77-112 (Law. Co-op. Supp. 1997) (effective Mar. 1, 1999).

150. S.C. CODE ANN. § 38-77-151 (Law. Co-op. Supp. 1997) (effective Mar. 1, 1999).

151. S.C. CODE ANN. § 38-77-122(B) (Law. Co-op. Supp. 1997) (effective Mar. 1, 1999).

152. See S.C. CODE ANN. § 38-77-280(F) (Law. Co-op. Supp. 1997) (effective until Mar. 1, 1999). After March 1, 1999, this provision may be found in section 33-77-280(D).

153. *Government Employees Ins. Co. v. Chavis*, 254 S.C. 507, 516, 176 S.E.2d 131, 135 (1970).

154. *Id.* (referring to nonrenewal as "termination").

155. S.C. CODE ANN. § 38-77-123(B) (Law. Co-op. Supp. 1997) (effective Mar. 1, 1999). A policy may also be canceled for falsifying information on the application. See *Chavis*, 254 S.C. at 516-17, 176 S.E.2d at 135.

156. S.C. CODE ANN. § 38-77-121(A) (Law. Co-op. Supp. 1997) (effective Mar. 1, 1999) (requiring the insertion of the statutory language governing cancellation in all automobile insurance contracts).

157. S.C. CODE ANN. § 38-77-123(A) (Law. Co-op. Supp. 1997) (effective Mar. 1, 1999).

158. *Id.* The list of prohibited factors for renewal of policies is more expansive than the list of prohibited factors for issuing new policies. Compare *id.* (containing forbidden categories for renewing policies), with S.C. CODE ANN. § 33-77-122(A) (Law. Co-op. Supp. 1997) (effective Mar. 1, 1999) (containing forbidden categories in issuing new policies).

the insurance company's decision by the Director of the Department of Insurance.¹⁵⁹ During this period, the policy must remain in force unless the policy has been canceled by some act of the insured, such as failure to pay premiums.¹⁶⁰ In addition, any individual may demand that the canceling or nonrenewing insurer provide the exact reason for the cancellation or nonrenewal within twenty-one days of such a written request.¹⁶¹ These provisions are enforceable by the Director and violations can subject an insurer to a \$200,000 fine.¹⁶²

IV. OPERATION OF THE RESIDUAL MARKET MECHANISMS

In 1999 the Reinsurance Facility will cease accepting new policies,¹⁶³ and a new JUA will begin operation.¹⁶⁴ The Reinsurance Facility will slowly wither in size until it stops issuing and renewing policies. The JUA will be the primary residual market mechanism through February 28, 2003, when the new assigned risk plan will take its place.¹⁶⁵ The JUA may also take several years to wither away as the policies it holds expire.

A. *The Joint Underwriter's Association*

The JUA must be self supporting.¹⁶⁶ In contrast to the Reinsurance Facility, which used the recoupment fee to recover losses from drivers not covered by the Facility, the JUA will set premiums prospectively to cover any losses it incurs.¹⁶⁷ Unlike the old method, the JUA will simply increase premiums to cover any losses sustained.¹⁶⁸ The JUA will not accept a driver until the ceding agent establishes that the driver has been denied coverage by a voluntary insurance company, and the agent supplies the reason for denial.¹⁶⁹

159. S.C. CODE ANN. § 38-77-123(D) (Law. Co-op. Supp. 1997) (effective Mar. 1, 1999).

160. *Id.*

161. S.C. CODE ANN. § 38-77-390 (Law. Co-op. Supp. 1997) (effective Mar. 1, 1999).

162. S.C. CODE ANN. § 38-77-123(G) (Law. Co-op. Supp. 1997) (effective Mar. 1, 1999).

163. On March 1, 1999, designated agents will no longer be allowed to cede policies to the Reinsurance Facility. S.C. CODE ANN. § 38-77-590(g) (Law. Co-op. Supp. 1997) (repealed effective Jan. 1, 2006).

164. *See* S.C. CODE ANN. § 38-91-10 (Law. Co-op. Supp. 1997) (effective Mar. 1, 1999, until Feb. 28, 2003).

165. *See id.*; S.C. CODE ANN. § 38-77-810 (Law. Co-op. Supp. 1997) (effective Mar. 1, 2003) (establishing the start date of the assigned risk plan).

166. S.C. CODE ANN. § 38-91-220(c) (Law. Co-op. Supp. 1997) (effective Mar. 1, 1999, until Feb. 28, 2003).

167. *Id.* The Reinsurance Facility set the recoupment fee to cover losses suffered in the previous year. *See* S.C. CODE ANN. § 38-77-600 (Law. Co-op. Supp. 1997) (repealed effective Jan. 1, 2006).

168. S.C. CODE ANN. § 38-91-220(c) (Law. Co-op. Supp. 1997) (effective Mar. 1, 1999, until Feb. 28, 2003) (requiring the JUA to set rates prospectively to cover losses).

169. S.C. CODE ANN. § 38-91-210(a) (Law. Co-op. Supp. 1997) (effective Mar. 1, 1999, until Feb. 28, 2003).

The JUA's goal is to place as many drivers in the voluntary market as possible.¹⁷⁰ Pursuant to this goal, the Director has the power to assign a driver to any carrier that is willing to provide coverage in the voluntary market.¹⁷¹ The code does not require that this "voluntary" insurer have rates lower than those of the JUA. The analogous section of the South Carolina assigned risk plan also includes this provision, but instead requires that the insurer "provide the insurance in the voluntary market at a rate *less than* the Associated Automobile Insurers Plan rate."¹⁷² Perhaps the General Assembly inadvertently omitted the word "lower" from the JUA statute. Assigning drivers to carriers with lower rates than the operating facility provides a safety net for drivers that are unable to find these lower rates on their own. Moreover, assigning drivers outside the JUA also reduces the number of drivers in the JUA. Because the JUA's rates must be set to accurately cover losses,¹⁷³ assigning drivers to higher cost carriers should not hurt or improve the JUA's bottom line. The JUA, therefore, would not benefit from assigning the driver to a higher cost carrier, and the driver would be faced with higher premiums.

The new law penalizes brokers and agents that place clients in the Facility when the voluntary market could have insured them.¹⁷⁴ However, these penalties do not apply if agents have less than ten percent of their policies in the JUA.¹⁷⁵ Agents that exceed this "safe harbor" and place insurable clients in the Facility will be subject to a penalty of \$5000 per driver.¹⁷⁶ Penalties also include suspension from writing policies for the JUA¹⁷⁷ and revocation of the broker's insurance license.¹⁷⁸ These provisions give significant incentives. Drivers placed in the JUA will pay higher premiums than those in the voluntary market because they will be pooled with the state's most unprofitable drivers. From an agents' perspective, placing more than ten percent of their clients in the JUA, which is above the safe harbor limit, may raise doubts about their underwriting decisions. However, agents must offer to place any drivers in the JUA for which they cannot find voluntary coverage.¹⁷⁹

170. *See id.* § 38-91-210(c) (providing penalties for ceding policies that could have been covered in the voluntary market).

171. *Id.* § 38-91-210(b).

172. S.C. CODE ANN. § 38-77-845(B) (Law. Co-op. Supp. 1997) (effective Mar. 1, 2003) (emphasis added).

173. S.C. CODE ANN. § 38-91-220(c) (Law. Co-op. Supp. 1997) (effective Mar. 1, 1999, until Feb. 28, 2003).

174. S.C. CODE ANN. § 38-91-210(c) (Law. Co-op. Supp. 1997) (effective Mar. 1, 1999, until Feb. 28, 2003).

175. *Id.*

176. *Id.*

177. *Id.*

178. *Id.*

179. *Id.* § 38-91-210(a).

B. The Assigned Risk Plan

The new South Carolina assigned risk plan requires the Director to assign to insurance companies those drivers that cannot find insurance on the voluntary market.¹⁸⁰ In most assigned risk plans, drivers are assigned “to insurance companies in proportion to the [insurer’s] market share.”¹⁸¹ The insurance company is then required to issue a policy that at least meets the state law minimum for coverage.¹⁸² The rates and rating tiers, set by the Director, are supposed to be sufficient to cover any losses by the assigned insurance company.¹⁸³

Regulations by the Director ultimately will control the assigned risk plan, like its predecessors.¹⁸⁴ The General Assembly has simply laid the framework for the system. The actual implementation of the system will be left largely to the Department of Insurance.¹⁸⁵ For example, the Director has discretion regarding how many risk pools to create¹⁸⁶ and whether to segregate, for fairness or administrative ease, private passenger insurance from commercial risk.¹⁸⁷

The assigned risk plan, like the JUA, has some institutional controls to prevent drivers insurable on the voluntary market from being placed in the plan.¹⁸⁸ Before drivers can be assigned to the Plan, agents will have to provide the name of another insurer who has denied coverage and the reason for the denial.¹⁸⁹ Also similar to the JUA, the Director can assign a driver to a voluntary provider willing to offer insurance at a lower rate than that provided by the assigned risk plan.¹⁹⁰

The adoption of an assigned risk plan is an important change in South Carolina’s automobile insurance system. However, it is not uncharted territory. Assigned risk plans are the most common residual market mechanism in the nation.¹⁹¹ South Carolina should be familiar with assigned risk plans because it was

180. S.C. CODE ANN. § 38-77-810 (Law. Co-op. Supp. 1997) (effective Mar. 1, 2003).

181. SOUTH CAROLINA LEGISLATIVE AUDIT COUNCIL, *supra* note 29, at 2.

182. S.C. CODE ANN. § 38-77-820 (Law. Co-op. Supp. 1997) (effective Mar. 1, 2003).

183. S.C. CODE ANN. § 38-77-810 (Law. Co-op. Supp. 1997) (effective Mar. 1, 2003).

184. *See id.* (permitting the Director to prescribe regulations designed to implement and enforce the assigned risk plan); *see also* S.C. CODE ANN. § 38-77-510 (Law. Co-op. Supp. 1997) (repealed effective Jan. 1, 2006) (making the Reinsurance Facility subject to regulations of the Director).

185. The Director is only required to issue a “reasonable” plan for the allocation of risks. S.C. CODE ANN. § 38-77-810 (Law. Co-op. Supp. 1997) (effective Mar. 1, 2003).

186. The assigned risk plan also allows insurance companies to create their own pools for assigning risk. *See* S.C. CODE ANN. § 38-77-830 (Law. Co-op. Supp. 1997) (effective Mar. 1, 2003) (allowing insurers to join together and “establish an Assigned Risk Pool”).

187. S.C. CODE ANN. § 38-77-810 (Law. Co-op. Supp. 1997) (effective Mar. 1, 2003); *see also* S.C. CODE ANN. § 38-77-880 (Law. Co-op. Supp. 1997) (effective Mar. 1, 2003) (mandating that the assigned risk plan also be available to commercial carriers).

188. *See supra* notes 169-71 and accompanying text (discussing controls on the JUA).

189. S.C. CODE ANN. § 38-77-841 (Law. Co-op. Supp. 1997) (effective Mar. 1, 2003).

190. S.C. CODE ANN. § 38-77-845(B) (Law. Co-op. Supp. 1997) (effective Mar. 1, 2003). If rates are set high enough to allow for adequate profits, very few drivers would ever have to be assigned.

191. *See* SOUTH CAROLINA LEGISLATIVE AUDIT COUNCIL, *supra* note 29, at 2.

this state's residual market mechanism prior to 1974.¹⁹² Additionally, South Carolina currently runs an assigned risk plan for worker compensation insurance.¹⁹³ Nevertheless, the eight-year transition in automobile insurance from the Reinsurance Facility through the JUA to the assigned risk plan may prove to be a "wild ride" for some of this State's drivers.

V. ANALYSIS OF THE CHANGE IN THE RESIDUAL MARKET MECHANISM

A. *The Creation of Both the JUA and the Assigned Risk Plan*

The General Assembly's decision to eliminate the Reinsurance Facility was aimed largely at eliminating the recoupment fee.¹⁹⁴ However, the replacement of the Facility is the result of a political compromise.¹⁹⁵ Instead of choosing either an assigned risk plan or a JUA, the legislators chose to have both.¹⁹⁶ In support of this compromise, the JUA is very much like the current Facility without the recoupment fee paid by drivers outside the JUA.¹⁹⁷ The advantage is that the pace of change will be slow. The assigned risk plan, however, is a more substantial change and will require more adjustment. For example, instead of sharing losses, insurance companies will have to cover losses individually from clients assigned to them.¹⁹⁸ If the goal of the legislation was to simplify the current system, the General Assembly has failed.¹⁹⁹ When the assigned risk plan begins operation, South Carolina will have all three major types of residual market mechanisms operating at once.²⁰⁰ Moreover, the creation of both the JUA and the assigned risk plan is

192. See Jim Parker, *State's Automobile Insurance Reform Will Take Motorists on Wild Ride*, THE POST AND COURIER (Charleston, S.C.), Sept. 7, 1997, at 1A.

193. See S.C. CODE ANN. § 38-73-540 (Law. Co-op. Supp. 1997).

194. See John Heilprin, *Insurance Bill Sped to House*, THE POST AND COURIER (Charleston, S.C.), Feb. 13, 1997, at 1A ("One of our primary goals will be to eliminate the recoupment fee." (quoting House Majority Leader Bobby Harrell, R-Charleston)).

195. See Jim Davenport, *Beasley Awaits Car Insurance Plan*, THE STATE (Columbia, S.C.), June 6, 1997, at A6.

196. See Act of July 2, 1997, No. 154, 1997 S.C. Acts 931.

197. The JUA still provides for group sharing of losses initially by insurance companies. See S.C. CODE ANN. § 38-91-110(c)(2) (Law. Co-op. Supp. 1997) (effective Mar. 1, 1999, until Feb. 28, 2003). However, these losses will only be recovered from drivers enrolled in the association. S.C. CODE ANN. § 38-91-220(C) (Law. Co-op. Supp. 1997) (effective Mar. 1, 1999, until Feb. 28, 2003) (requiring rates to be self-supporting).

198. See S.C. CODE ANN. § 38-77-820 (Law. Co-op. Supp. 1997) (effective Mar. 1, 2003) (requiring insurance companies to provide coverage with no sharing of losses).

199. See Jim Davenport, *Insurance Reform Could Cost Many Drivers*, THE STATE (Columbia, S.C.), Mar. 19, 1997, at B5 (stating that the goal of the new legislation was to simplify the current system).

200. The Reinsurance Facility will not be eliminated until 2006. S.C. CODE ANN. § 38-77-530 (Law. Co-op. Supp. 1997) (repealed effective Jan. 1, 2006). The JUA will still hold policies after it stops accepting new policies on March 1, 2003. S.C. CODE ANN. § 38-91-10(B) (Law. Co-op. Supp. 1997) (effective Mar. 1, 1999, until Feb. 28, 2003). The assigned risk plan begins operation on March

more the result of political differences than a desire to make a smooth change in residual market mechanisms.²⁰¹

B. The Price Comparison

A comparison of the price of a JUA and an assigned risk plan can be made by analyzing the mechanisms used by Virginia and Florida. Florida operates a JUA,²⁰² and Virginia operates an assigned risk plan.²⁰³ Although this Note has dealt mainly with liability insurance, it would be deceiving to look at liability costs alone when comparing insurance systems. Therefore, this section will consider the average price of an insurance policy including coverage for such things as physical damage.

In 1995 South Carolina's average automobile insurance premium was \$676.²⁰⁴ Virginia, which runs an assigned risk plan, had an average premium of \$603.²⁰⁵ Florida, which runs a JUA, had average premium of \$779.²⁰⁶ North Carolina, which employs a Reinsurance Facility, had the lowest average premium in the region at \$577.²⁰⁷ If cost alone were the only factor, the General Assembly should have kept the Reinsurance Facility and modified it to more closely resemble that of North Carolina. However, merely comparing the average premiums from different residual market mechanisms is a simplistic analysis. Switching to a different state's system would not mean that premiums in South Carolina would change accordingly. For example, any comparison with Florida is strained because Florida is a "no fault" state.²⁰⁸ Rates are ultimately affected by state laws and policies that affect the number and severity of accidents such as the licensing system for teenage drivers and the enforcement and severity of DUI laws.²⁰⁹

Highway death rates provide an avenue for comparison between South Carolina and Virginia. South Carolina's highway death rate was ranked the eighth highest in the nation in 1995.²¹⁰ Virginia was ranked thirty-fifth.²¹¹ Simply changing the residual market mechanism is unlikely to bring premiums down to the level enjoyed in Virginia given, among other factors, the disparity of the highway death rates.

1, 2003. S.C. CODE ANN. § 38-77-810 (Law. Co-op. Supp. 1997) (effective Mar. 1, 2003).

201. The assigned risk plan could be directly implemented. See SOUTH CAROLINA LEGISLATIVE AUDIT COUNCIL, *supra* note 29, at 52 (recommending the creation of an assigned risk plan).

202. See *id.* at 2.

203. *Id.*

204. See Parker, *supra* note 192.

205. *Id.*

206. *Id.*

207. *Id.*

208. See FLA. STAT. ANN. §§ 627.730 to 627.7405 (West 1996). No fault is an alternative to the traditional tort-based system. Under the no-fault system, drivers pay for their own losses regardless of who was at fault in the accident. See BANKS MCDOWELL, *THE CRISIS IN INSURANCE REGULATION* 79-84 (1994).

209. See SOUTH CAROLINA LEGISLATIVE AUDIT COUNCIL, *supra* note 29, at 40-47.

210. See Parker, *supra* note 7, at 17A.

211. *Id.*

Before South Carolina can see major drops in automobile insurance rates, it must reduce the root cause of insurance cost: injuries and fatalities on our roadways.²¹²

The shift to a JUA in 1999 will have an immediate impact on rates for some drivers. Good drivers, those with no traffic violations, are likely to see slightly lower insurance costs.²¹³ The worst drivers in the state, at least initially, could see a dramatic reduction in rates due to the cap on the recoupment fee.²¹⁴ Currently, these drivers pay more than their share of losses because of the punitive nature of the recoupment fee.²¹⁵ However, this benefit will be short-lived as insurance companies raise premiums on these drivers under their newly devised rating schemes. Drivers with old tickets but no insurance points should also expect higher premiums as those tickets reappear with the repeal of the three-year forgiveness rule.²¹⁶ Finally, teenagers, young adults, and the elderly can all expect their rates to rise due to the elimination of the Uniform Classification Plan.²¹⁷

VI. MINOR CHANGES IN THE LAW

A. *Enforcing the Requirement to Carry Insurance*

The only aspect of the 1997 legislation designed to take effect immediately is the requirement that all motorists carry proof of insurance in their cars.²¹⁸ Motorists that fail to comply face a fine of no more than \$100.²¹⁹ Drivers ticketed for failure to have proof of insurance will have to prove their policy was valid within thirty days or their driver's license will be suspended.²²⁰ Additionally, they will have to provide proof of current insurance every quarter for a year or have their license suspended.²²¹

Requiring motorists to carry insurance is an important step in fighting the

212. See Jim Davenport, *Effect of Insurance Changes Uncertain*, THE STATE (Columbia, S.C.), Mar. 31, 1997, Moneywise 3.

213. See Davenport, *supra* note 10 (predicting minor savings for good drivers); Parker, *supra* note 192 (15-20% reduction for drivers with no tickets or accidents for five years).

214. See Davenport, *supra* note 10.

215. S.C. CODE ANN. § 38-77-600 (Law. Co-op. Supp. 1997) (repealed effective Jan. 1, 2006).

216. See *supra* notes 126-28 and accompanying text.

217. See 25A S.C. CODE ANN. REGS. 69-13.4 (1976) (repealed 1996 but still in effect) (detailing the Uniform Classification Plan).

218. See S.C. CODE ANN. § 56-10-225 (Law. Co-op. Supp. 1997). Absent from this provision is an exemption for drivers that opt to pay a fee and drive uninsured. Because the option to drive uninsured does not go into effect until February 1, 1999, the General Assembly has until then to exempt such drivers from the mandatory requirement to carry proof of insurance. Perhaps, the lawfully uninsured should be required to carry proof of fee payment instead of proof of insurance.

219. The penalty is declared to be the same as the penalty for not having proof of registration in the car. S.C. CODE ANN. § 56-10-225(C) (Law. Co-op. Supp. 1997). The penalty for failing to have proof of registration falls under the "catch-all" misdemeanor penalty provision of S.C. CODE ANN. § 56-3-2520 (Law. Co-op. 1991).

220. S.C. CODE ANN. § 56-10-225(C) (Law. Co-op. Supp. 1997).

221. *Id.*

problem of uninsured motorists. A recent report estimated that in 1995 ten percent of drivers, over 285,000, operated automobiles in South Carolina without insurance.²²² South Carolina previously had a system that required individuals stopped for traffic violations to fill out a form to verify insurance.²²³ However, the law was not enforced due to the administrative difficulties and financial burden it placed on law enforcement officials.²²⁴ As a result, the law was repealed in favor of a law allowing officers to issue forms at their discretion.²²⁵

The new law is less burdensome on law enforcement personnel because an officer now only needs to see a valid insurance card. Although carrying an insurance card may burden motorists, it is an efficient alternative to the previous insurance checking systems. If the requirement leads to more motorists purchasing insurance, thereby lowering the cost of insurance for insured drivers, few drivers should object to the minimal inconvenience. However, the new law will not solve the problem of drivers that initially acquire insurance, and a valid insurance card, and then fail to make the periodic payments leading to the cancellation of their policies.

The General Assembly has also required the Department of Public Safety to implement programs to catch uninsured drivers.²²⁶ One of these programs requires the Department to randomly sample five hundred vehicles per day.²²⁷ Drivers that fail to prove they have insurance will be prosecuted as uninsured motorists.²²⁸ Other states have gone further and tried to catch all uninsured motorists with complex computer databases.²²⁹ However, several of these states have faced problems with computers erroneously reporting drivers as uninsured.²³⁰

B. Elimination of Designated Agent System

Currently, South Carolina has two distinct types of insurance agents: designated agents and voluntary agents. Designated agents only sell automobile policies for the Reinsurance Facility.²³¹ Drivers that go to a designated agent will always be placed in the Reinsurance Facility no matter what their risk.²³² Voluntary agents sell insurance for private insurance companies *and* for the Reinsurance

222. SOUTH CAROLINA LEGISLATIVE AUDIT COUNCIL, *supra* note 29, at 36.

223. *Id.* at 36-37.

224. *Id.*

225. See S.C. CODE ANN. § 56-7-12 (Law. Co-op. Supp. 1997).

226. See S.C. CODE ANN. § 56-10-553(B) (Law. Co-op. Supp. 1997) (effective Feb. 1, 1999).

227. *Id.* § 56-10-553(C).

228. *Id.*

229. INSURANCE INFORMATION INSTITUTE, *Compulsory Automobile Insurance*, in INS. ISSUES UPDATE, Dec. 1997, at 24, available in LEXIS, Insure Library, IIRPTS File.

230. See *id.*

231. See SOUTH CAROLINA LEGISLATIVE AUDIT COUNCIL, *supra* note 29, at 26.

232. *Id.* at 6.

Facility.²³³ Designated agents were created in 1974 in response to a concern that automobile insurance might be inaccessible in some areas of the state.²³⁴ Designated agents were also created to provide jobs for unemployed insurance agents that lost their jobs due to the establishment of the Reinsurance Facility.²³⁵ Twenty-four years later these designated agents still exist, but the original justification for their existence has disappeared. Enough time has passed for most "displaced" agents to find new work. Additionally, designated agents have been placed "in areas of the state already served by insurance agents in the voluntary market."²³⁶ Columbia, South Carolina, for example, has over six hundred voluntary agents and twelve designated agents.²³⁷ The new legislation eliminates the designated agent.²³⁸ Because designated agents only sell insurance in the residual market mechanism, they do not comport with the new legislation's goal of placing drivers in the voluntary market whenever possible²³⁹ and the requirement that ceding agents first deny coverage in the voluntary market to the driver.²⁴⁰

C. Minimum Property Requirement Raised

Beginning March 1, 1999, the property damage minimum will be raised from \$5,000 to \$10,000.²⁴¹ Such a step is long overdue. Virginia, the model for the Plan, requires \$20,000 of property damage coverage in automobile policies.²⁴² Prior to the increase, South Carolina was tied with four other states for the lowest mandatory property coverage in the nation.²⁴³ When the minimum property damage was last set in 1974,²⁴⁴ \$5,000 was probably a reasonable figure to cover the property damage in most accidents. However, with the average cost of a new automobile now at over \$22,000,²⁴⁵ the \$5,000 limit is simply antiquated. The new \$10,000 minimum would still only pay half the cost of a typical new car if totaled in an accident.²⁴⁶ In this regard, the General Assembly should consider raising the property damage

233. *Id.*

234. *Id.* at 26.

235. *Id.*

236. *Id.* at 28.

237. SOUTH CAROLINA LEGISLATIVE AUDIT COUNCIL, *supra* note 29, at 28.

238. See S.C. CODE ANN. § 38-77-595 (Law. Co-op. Supp. 1997) (effective Mar. 1, 1999, until Jan. 1, 2006).

239. See *supra* notes 170-71 and accompanying text.

240. See S.C. CODE ANN. § 38-77-841 (Law. Co-op. Supp. 1997) (effective Mar. 1, 2003).

241. S.C. CODE ANN. § 38-77-140 (Law. Co-op. Supp. 1997) (effective Mar. 1, 1999).

242. VA. CODE ANN. § 46.2-472 (Michie 1996).

243. For a current listing of property damage minimums in all states, see *Insurance News Network* (visited June 18, 1998) <<http://www.insure.com/auto/mimimum.html>>.

244. S.C. CODE ANN. § 38-77-140 (Law. Co-op. 1976).

245. See Al Haas, *Fun Cars—Good Prices*, THE STATE (Columbia, S.C.), Jan. 16, 1998, at E1 (stating that the average cost of a new car, as reported by the National Automobile Dealers Association, is \$22,263).

246. See *id.*

minimum to more accurately reflect the value of today's automobiles.

D. Allowing Brokers and Agents to Rebate Commissions

Beginning March 1, 1999, insurance agents will be allowed to rebate part of their commissions to their clients.²⁴⁷ However, rebating will be limited to automobile insurance only.²⁴⁸ The repeal of the rebate law will allow consumers to bargain more effectively with insurance agents and lower the total price of insurance. In this regard, the rebate law has undergone a historical metamorphosis. Anti-rebate laws were an early product of state antidiscrimination movements, and insurance agents anxious to increase commissions supported these laws.²⁴⁹ By 1960 all states had some form of anti-rebate law.²⁵⁰ The laws originally responded to a belief that a privileged few were being sold insurance at discounts unrelated to actuarial risk and unavailable to members of the general public.²⁵¹ Ironically, the anti-rebate law, an early consumer protection measure, is now being repealed to better service the consumer.

VII. CONCLUSION

The 1997 automobile insurance legislation did not eliminate South Carolina's traditional tort-based insurance system. However, the legislation did completely overhaul the automobile insurance system. The Reinsurance Facility, and its hated recoupment fee, will be gradually eliminated in favor of a JUA and ultimately an assigned risk plan. The current mandates of writing policies for all applicants, uniformity in rating, and rate control from the Department of Insurance combined to create a stable atmosphere for consumers. The elimination of these controls will create a new insurance climate driven by market forces instead of regulation. This new climate should benefit some drivers because out-of-state carriers may now compete with current carriers for drivers' insurance dollars. However, other drivers will be hurt by the loss of regulatory protection. In the final analysis, the automobile insurance reform of 1997 provides a new competitive climate with opportunities and potholes for South Carolina drivers. Time will tell if it is a change for the better.

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247. S.C. CODE ANN. § 38-43-200(e) (Law. Co-op. Supp. 1997) (effective Mar. 1, 1999).

248. *Id.*

249. *See* Gaulding, *supra* note 15, at 1656.

250. *Id.*

251. *Id.*

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